

MANDATORY COUNSELING

**Judge Jack Caddell
United States Bankruptcy Court
Decatur, Alabama**

Individual debtors who file bankruptcy on or after October 17, 2005 must receive an individual or group briefing from an approved nonprofit budget and credit counseling agency during the 180 day period preceding the petition date.¹ Under § 111(c)(2)(E), approved nonprofit credit counseling agencies are directed to provide debtors with counseling “that includes an analysis of such client’s current financial condition, factors that caused such financial condition, and how such client can develop a plan to respond to the problems without incurring negative amortization of debt.” The briefing may be conducted by telephone or on the internet. An agency that provides telephonic or internet services must be able to demonstrate sufficient proficiency in designing and providing such services. Application instructions prepared by the U.S. trustee for approval as a credit counseling agency state that the average length of an adequate briefing is considered 90 minutes. The briefing must outline the opportunities for credit counseling and assist the debtor “in performing a related budget analysis.”² Individual debtors who fail to obtain the briefing are ineligible for relief unless one of three exceptions apply.

EXCEPTIONS

The credit counseling requirement is waived under § 109(h)(4) with respect to a debtor who

¹ 11 U.S.C. § 109(h)(1).

² 11 U.S.C. § 109(h)(1).

is unable to comply because of “incapacity, disability, or active military duty in a military combat zone.”³ Incapacity is defined as impairment by reason of mental illness or deficiency, and disability refers to a physical impairment that would prohibit the debtor from participating in person, over the phone, or through the internet.⁴ This exception requires a court determination made after notice and hearing.

Pursuant to § 109(h)(3)(A), a debtor may request a waiver of the credit counseling requirement based on exigent circumstances, for a period of 30 days, if the debtor submits a certification with the petition that:

- (i) describes exigent circumstances that merit a waiver of the requirements of paragraph (1);
- (ii) states that the debtor requested credit counseling services from an approved nonprofit budget and credit counseling agency, but was unable to obtain the services referred to in paragraph (1) during the 5-day period beginning on the date on which the debtor made that request; and
- (iii) is satisfactory to the court.

The waiver expires 30 days after the debtor files the petition, “except that the court, for cause, may order an additional 15 days.”⁵

For debtors who reside in a district where the U.S. trustee or bankruptcy administrator has determined that approved agencies are not reasonably able to provide counseling services to additional individuals, the credit counseling requirement is waived pursuant to § 109(h)(2)(A).⁶ The

³ 11 U.S.C. § 109(h)(4).

⁴ 11 U.S.C. § 109(h)(4).

⁵ 11 U.S.C. § 109(h)(3)(B).

⁶ 11 U.S.C. § 109(h)(2)(A).

U.S. trustee and bankruptcy administrator are charged with reviewing a determination made under § 109(h)(2)(A) not later than 1 year after the date of such determination.

FILING REQUIREMENTS

Pursuant to § 521(b)(1) and(2), individual debtors must file a certificate from an approved credit counseling agency that describes the services provided to the debtor and “a copy of the debt repayment plan, if any, developed under section 109(h)” by the agency. Interim Bankruptcy Rule 1007(b)(3) implements the filing requirement under § 521(b) and the related exceptions as follows:

Unless the United States trustee has determined that the credit counseling requirement of § 109 does not apply in the district, an individual debtor must file the certificate and debt repayment plan, if any, required by § 521(b), a certificate under § 109(h)(3), or a request for a determination by the court under § 109(h)(4).

The documents required by subdivision 1007(b)(3) must be filed with the petition. *See* Interim Bankruptcy Rule 1007(c). An extension of the time for filing the documents required by subdivision 1007(b)(3) “may only be granted on motion for cause shown and on notice to the United States trustee and to any committee elected under § 705 or appointed under § 1102 of the Code, trustee, examiner, or other party as the court may direct.”⁷

The petition, Official Form 1, is amended to include a check box on the second page of the form in which a debtor must indicate that counseling services were received during the 180 day period preceding the petition date or to request a waiver of the requirement based on exigent circumstances discussed above. The form directs the debtor requesting waiver to attach a certificate describing the exigent circumstances.

⁷ Bankruptcy Rule 1007(c).

NONPROFIT BUDGET AND CREDIT COUNSELING AGENCIES

The U.S. trustee's office is charged with the responsibility for overseeing and approving nonprofit budget and credit counseling agencies according to the criteria set forth under 11 U.S.C. § 111.⁸ In Alabama and North Carolina the U.S. bankruptcy administrator's office is charged with the responsibility. The clerk of the court must maintain a publicly available list of approved credit counseling agencies.⁹ The list will be posted on the court's website and a hard copy will be available at the clerk's office.

To be approved, a budget and credit counseling agency must be organized and operated as a nonprofit entity. The agency must "provide trained counselors who receive no commissions or bonuses based on the outcome of the counseling services."¹⁰ The agency must maintain adequate financial security for safekeeping funds paid to the agency by a debtor through a debt management plan. The fees charged by the agency must be reasonable and the agency must provide services without regard to ability to pay.¹¹ The agency must fully disclose to a debtor how the agency is funded, counselor qualifications, the possible impact on the debtor's credit reports, and any costs of the program that will be paid by the debtor.¹² The Bankruptcy Reform Act provides no funding for the services that all individual debtors are now required to obtain as a condition of filing

⁸ 11 U.S.C. § 111(b), (c).

⁹ 11 U.S.C. § 111(a).

¹⁰ 11 U.S.C. § 111(c)(2)(F).

¹¹ 11 U.S.C. § 111(c)(2)(B).

¹² 11 U.S.C. § 111(c)(2)(D).

bankruptcy.¹³ The only provision for fees is the requirement under § 111(c)(2)(B) that any fee charged for counseling services must be reasonable.

Agency compensation is often derived from what is referred to in the credit counseling industry as “fair share” payments.¹⁴ Fair share payments are based on percentage fees that agencies negotiate with each creditor receiving payments under the consumer’s debt repayment plan.

In a recent bankruptcy case involving a national credit counseling agency, AmeriDebt, Inc., the district court described the standard practices of such agencies:

Credit counseling takes various forms, including finding alternative funding sources for the consumer, giving him guidance on how to handle finances in the future, placing him on a Debt Management Plan (DMP), and finally assisting him in filing for bankruptcy. Restructuring debt through a DMP allows a consumer to consolidate unsecured debt, lower his interest rates and monthly payments, obtain re-aging of his debts, and/or curtail collection calls, penalties, and over-limit fees. Typically, under a DMP a consumer signs a contract agreeing to make monthly payments to [the credit counseling agency], which then makes arrangements with the consumer’s end-creditors and distributes payments to them.¹⁵

The Federal Trade Commission sued AmeriDebt, Inc. for misrepresentations and deceptive omissions under the Federal Trade Commission Act that resulted in hidden fees charged to consumers under debt repayment plans. The *AmeriDebt* bankruptcy raised concerns with regard to the industry that is now described as the gatekeeper of the bankruptcy system.¹⁶

¹³ See Patricia A. Redmond, *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Summary of Certain Critical Consumer and Exemption Provisions*, SL068 ALI-ABA 25, 30 (2005).

¹⁴ See Sue Ann Slates, *A New Role for United States Trustees: Approval of Credit Counseling Services*, AM. BANKR. INST. J., Vol. XVIII, No. 5, June 1999.

¹⁵ *Fed. Trade Comm. v. AmeriDebt, Inc. (In re AmeriDebt, Inc.)*, 343 F.Supp.2d 451, 454 (D. MD 2004).

¹⁶ See *supra* notes 12 and 13.

ALTERNATIVE REPAYMENT SCHEDULE

To encourage unsecured creditors to enter into an alternative repayment schedule or debt repayment plan with a financially distressed consumer outside of bankruptcy, Congress added § 502(k)(1) pursuant to which an unsecured creditor's claim may be reduced by not more than 20% if the creditor refuses to negotiate a reasonable alternative payment schedule proposed on behalf of a debtor by an approved agency. Newly added § 502(k)(1) provides:

The court, on motion of the debtor and after a hearing, may reduce a claim filed under this section based in whole on an unsecured consumer debt by not more than 20 percent of the claim, if –

(A) the claim was filed by a creditor who unreasonably refused to negotiate a reasonable alternative repayment scheduled proposed on behalf of the debtor by an approved nonprofit budget and credit counseling agency described in section 111;

(B) the offer of the debtor under subparagraph (A) –

(i) was made at least 60 days before the date of the filing of the petition; and

(ii) provided for payment of at least 60 percent of the amount of the debt over a period not to exceed the repayment period of the loan, or a reasonable extension thereof; and

(C) no part of the debt under the alternative repayment schedule is nondischargeable.

The debtor must prove the elements under § 502(k)(1) by clear and convincing evidence.¹⁷

As additional incentive for unsecured creditors to work with debtors outside of bankruptcy, Congress added § 547(h) pursuant to which a trustee may not avoid a transfer made to creditors as part of an alternative repayment schedule created by an approved credit counseling agency.

¹⁷ 11 U.S.C. § 502(k)(2).

DEBTOR EDUCATION

Newly added § 727(a)(11) of the Bankruptcy Code bars the Chapter 7 discharge unless the debtor completes a post-petition instructional course on personal financial management. A similar bar to the Chapter 13 discharge is provided in § 1328(g)(1) of the Bankruptcy Code. The bar to discharge does not apply if the debtor is unable to comply because of incapacity, disability, or active military duty in a military combat zone as described in § 109(h)(4). The debtor will also be excused if the bankruptcy administrator determines that the approved instructional course is not currently available for additional individuals.¹⁸ The personal financial management course is described in § 111 of the Bankruptcy Code. The amendments require the approved instructional course to provide debtors with “learning materials and teaching methodologies designed to assist debtors in understanding personal financial management”¹⁹

Bankruptcy Rule 1007(b)(7) is amended to require individual Chapter 7 and 13 debtors to file a statement regarding the completion of a course in personal financial management.²⁰ Official Form 23, entitled Debtor’s Certification of Completion of Instructional Course Concerning Personal Financial Management, must be filed “within 45 days after the first date set for the meeting of creditors under § 341 of the Code in a chapter 7 case, and no later than the last payment made by the debtor as required by the plan or the filing of a motion for entry of a discharge under § 1328(b)

¹⁸ 11 U.S.C. § 727(a)(11).

¹⁹ 11 U.S.C. § 111(d)(1)(B).

²⁰ *See* Official Form 23.

in a chapter 13 case.”²¹ The completed form will signal the clerk that the condition of discharge has been satisfied.

²¹ Bankruptcy Rule 1007(c).